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# **Malaysia: Mahathir Under Pressure**

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**An Intelligence Assessment**

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*EA 84-10003  
January 1984*

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**An Intelligence Assessment**

This paper was prepared by [redacted]  
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**Key Judgments**

*Information available  
as of 3 January 1984  
was used in this report.*

Prime Minister Mahathir arrives in Washington in his most vulnerable political position since taking office in 1981. Over the past year he has faced:

- A slowdown in the growth of government spending that threatens his goal of giving ethnic Malays economic parity with the ethnic Chinese.
- A banking scandal that may implicate officials at the highest levels of government.
- A bitter dispute with Malaysia's royalty over the legislative powers of the king.

These problems, combined with a prickly personality and a tendency to promote younger party members to important positions, have earned him enemies among his party's conservative old guard, which is likely to challenge him in party elections this spring. The ongoing banking scandal and economic problems could cost him public support as well.

As a result, we expect Mahathir to have less freedom of movement over the next year, and he probably will be forced to give way to his opponents in some areas. In order to placate ethnic Malays, unhappy with Mahathir's economic policies and his dispute with the royalty, he might adopt an even more strident economic nationalist stance or emphasize Islamic policies. He may also bring more conservative party members into the government in an attempt to placate the old guard. If adopted, these measures would also reverse the warming trend in relations with the United States, returning the two countries to the strident confrontation over economic issues that characterized the early years of Mahathir's term.

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## Malaysia: Mahathir Under Pressure

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### An Aggressive Beginning

Mahathir bin Mohamad succeeded to the prime-ministership in July 1981 following the resignation of his predecessor, Hussein Onn. Anxious to win a five-year mandate on his own, Mahathir called for national elections the following April and conducted an aggressive and intense campaign. Despite an earlier reputation as a Malay chauvinist, Mahathir's dynamic style of leadership, coupled with an emphasis on honest and efficient government responsive to all ethnic groups, struck a responsive chord among the public, and his 11-party multiracial coalition (the National Front) swept to an overwhelming victory. The coalition captured 61 percent of the popular vote and 132 of Parliament's 154 lower house seats, with another 5 held by National Front allies.

After the election, Mahathir moved to consolidate his political position and reinforce his image as an advocate of Malay interests. He attempted to disarm the Malay right by bringing Anwar Ibrahim, the popular Malay fundamentalist youth leader, into the Cabinet and introducing "Islamic" subjects in high school and university curriculums. He also sought support among poorer Malays by accelerating housing subsidies and social spending—even in the face of economic difficulties. But he did not neglect non-Malays, and he has earned the gratitude of elements of the Chinese community by his measures to help the Chinese-dominated tin industry.

Not unexpectedly, his success has earned him enemies within his party, the United Malays National Organization (UMNO). Mahathir's major opponent is Minister of Finance Tunku Razaleigh Hamzah, who in 1981 unsuccessfully opposed Mahathir for UMNO's number-two position. Razaleigh, according to party members, believes Mahathir did not give him due recognition for the major role he played in organizing the National Front election victory. Razaleigh has now made common cause with the party's conservative wing—the old guard—which does not like Mahathir's abrupt style or his practice of promoting

younger politicians to important government and party positions. The old guard also claims Mahathir has not sought the traditional Malay consensus before introducing important issues. In addition, some Malay chauvinists believe that the Prime Minister has retreated from his earlier days of advocating Malay rights and that he has not done enough to emphasize Malaysia's Islamic identity.

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### The New Economic Policy and the Economy

At the same time Mahathir is facing opposition within his own party, a slowdown in the growth of government spending threatens his programs for Malaysian—and Malay—economic development. These programs are based on the New Economic Policy (NEP), which was created in 1970 to reduce foreign and ethnic Chinese control of the economy through government support for ethnic Malays. Because the redistribution is intended to be achieved without reducing the absolute level of Chinese economic holdings, its success is dependent on continuing economic growth.

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Through the 1970s, a buoyant economy, growing at an 8-percent annual rate, supported this redistribution. Government expenditures—financed by taxes on international trade and oil—rose nearly 20 percent in this period and funded increases in social spending along with the purchase by the Malay National Trust of equity in both Chinese and foreign businesses. As a result, the Malay share of the country's corporate wealth increased from 4.3 percent in 1971 to 12.4 percent a decade later.

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Since becoming Prime Minister, however, Mahathir has seen the global recession slow Malaysia's economic growth to 6 percent in 1981 and 4.6 percent in 1982. Depressed international commodity prices—especially for oil, tin, and rubber—reduced both

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export earnings and the government's trade-based revenues substantially. The 1982 current account deficit (which measures the balance of trade in goods and services) ballooned to \$3.4 billion—nearly 16 percent of GNP—a phenomenal swing from the surplus of \$1 billion in 1979. [ ]

Mahathir's first reaction to these financial strains was to boost foreign borrowing in an attempt to offset depressed export earnings and maintain economic development, social, and defense expenditures. As a result, Malaysia—which entered the 1980s with one of the smallest foreign debts in Asia—was transformed into one of the most aggressive foreign borrowers among developing countries, taking in an additional \$2.5 billion in 1982 alone, which raised the outstanding public foreign debt by one-third. The growth of the foreign debt continued at a similar pace in 1983. [ ]

Expansionary government spending along with recession-reduced tax revenues boosted the domestic budget deficit to \$4.2 billion in fiscal 1982—17 percent of GNP. In October 1982 Mahathir instituted a program of fiscal austerity aimed at holding down foreign borrowing and preserving Malaysia's high international credit rating. Although the economy, propelled by an export boom, improved markedly in 1983—with output growing at 5.6 percent, government revenues have not recovered much and budget austerity continues. The 1984 budget projects deep cuts in development spending (26 percent) and defense (20 percent); after adjusting for the anticipated 5- to 6-percent inflation in 1984, the cuts will bite even deeper. [ ]

Although the economy is likely to grow at more than 6 percent annually in the next few years, Malaysian officials do not expect government expenditures to return to the heady growth of the past decade. Government revenues are likely to expand more slowly than the economy as a whole unless there is another boom in commodity prices. And growth in government expenditures will also be restrained by concern over rapidly increasing payments on the foreign debt, according to the financial press. As a result, Malaysia—which has one of the highest ratios of government spending to GDP in non-Communist Asia (40

percent)—plans to reduce the relative role of government in the economy over the next few years. In addition to cutting development spending, Mahathir is also pushing “privatization” of the economy, which would have the government divest itself of activities such as power, transport, and communications in order to raise funds for other government projects. [ ]

If maintained, the reductions in development spending—the cornerstone of NEP—would be especially ominous to Mahathir's plans. Although public-sector construction is likely to remain constant in 1984 because of projects already in the pipeline, the cuts will affect both infrastructure and industrialization projects in the next few years. The government is thus likely to fall far short of its spending targets under the current five-year plan, which ends in March 1986, and of its goal of 30 percent Malay control of the economy by 1990. Mahathir, once considered a Malay chauvinist, ironically could become the scapegoat for NEP's failure to reach its goal. [ ]

#### **The Bank Bumiputra Scandal**

Mahathir's handling of the NEP is also under attack as a result of a major banking scandal involving Bank Bumiputra, the financial arm of the NEP. Bank Bumi, one of the largest commercial banks in ASEAN, is a quasi-governmental agency responsible directly to the Prime Minister. [ ]

The scandal broke in early 1983 with the revelation that Bank Bumi's wholly owned subsidiary in Hong Kong, Bumiputra Malaysia Finance (BMF), had made large unsecured loans to three Hong Kong Chinese property speculators. Much of the money—estimated by the financial press at more than \$700 million—has been lost because of the collapse of the Hong Kong property market. The atmosphere of scandal was heightened by the still unsolved murder of the BMF's chief auditor in Hong Kong last July, and the trial of Hong Kong property developer George Tan early this year is likely to result in further damaging revelations. [ ]

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The government's investigation, moreover, has been slow, leading to criticism of Mahathir by opposition figures and UMNO politicians alike. The opposition Democratic Action Party in October renewed its call for a Royal Commission to expedite the investigation and make the results public. [ ]

Both the Prime Minister and his opponent Razaleigh, however, have much to lose. Razaleigh, who was the Bank's chairman from 1970 to 1976 and the architect of its rapid growth, is closely identified with the Bank by most Malaysians. A close associate, Tan Sri Kamarul Ariffin, was chairman when most of the Hong Kong loans were made. The top executives of BMF, who were forced to resign in late October, are also closely tied to Razaleigh. [ ]

The bank's present chairman, Nawawi Mat Awini, is one of the Prime Minister's closest economic and financial advisers, according to the US Embassy. Critics point out that the BMF continued its loans into Nawawi's term—even though other international banks were avoiding such loans. Nawawi, who the Embassy says was once considered a strong candidate to replace Razaleigh, has already been hurt by his stonewalling of the investigation. For Mahathir, public findings showing that his protege Nawawi continued to approve loans even after the problems began to surface would call into question Mahathir's judgment in making personnel choices and would strengthen the old guard's claim that the Prime Minister's emphasis on new blood in party and government positions is ill advised. [ ]

#### **Mahathir's Pyrrhic Victory**

Mahathir's campaign to reduce the king's constitutional powers has given the old guard more ammunition. Malaysia's *Yang Dipertuan Agong* (king) has several powers granted by the constitution. He can:

- Prevent parliamentary legislation from becoming law by withholding royal assent.
- Declare an emergency without consulting the Prime Minister.
- Refuse to dissolve Parliament even if the Prime Minister recommends it.
- Appoint a prime minister of his own choosing. [ ]

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#### **Malaysia's Royalty**

*Malaysia has constitutional monarchs at both the national and state level. Nine of the country's 13 states have hereditary rulers, usually called sultans, whose families ruled their small states at the time of the British colonial takeover. Some, like the Raja of Perak, trace their line as far back as the 16th century. The British retained the local rulers during the colonial period, using them as a front for exercising power.* [ ]

*The position of Yang Dipertuan Agong (king) was created in 1957 at independence. The kingship rotates among the nine state rulers, who convene every five years in a Council of Rulers to elect a new king from among themselves. The present king, Tuanku Ahmad Shah of Pahang, is Malaysia's seventh, having reigned since 1979. His successor will be chosen in April and probably will come either from the royal houses of Johore or Perak, whose families have yet to give the country a king. Once a king has served his term, he returns to his position as state ruler.* [ ]

*The king can be impeached by Parliament but can only be removed by a majority vote of the Council of Rulers. In return for his national position the king may not receive any revenue from his home state, nor can he engage in any commercial enterprise. Court expenses are paid by the government from a fund called the Civil List.* [ ]

Although no king has yet invoked them, Mahathir fears that the king to be elected next April might use these powers to undercut the Prime Minister. [ ] the government is concerned that the Sultans of Johore and Perak, likely candidates to succeed the present King, intend to use the royal powers to promote legislation favoring ethnic Malay interests in a way unnecessarily antagonistic to

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Malaysia's Chinese and Indian communities. [redacted]

In August Mahathir passed through Parliament a constitutional amendment ending the need for royal assent on legislation and requiring the king to obtain the consent of the cabinet before declaring an emergency. The influence of state rulers would also be reduced. Malaysia's royalty saw the amendment as a direct challenge to its political and cultural role, and when the Council of Rulers—whose membership includes all nine of Malaysia's state monarchs—met on 12-15 October, they advised the King not to sign the amendment. According to the US Embassy, Mahathir was shaken by the vehemence of the Council's reaction. [redacted]

The Prime Minister's struggle with the rulers gave his opponents within UMNO a chance to attack Mahathir. The old guard presented itself as the defender of Malay interests, took the side of the sultans, and urged Mahathir to withdraw the amendment. The party's executive body, the Supreme Council, initially gave him only lukewarm support. Although the Prime Minister received the backing of UMNO's national-level youth and women's organizations, he did not do as well at the state level, where the old guard is more entrenched. [redacted]

Finally, in December, Mahathir was forced to compromise. In return for a modified amendment that allowed for a two-thirds vote of Parliament to override a royal veto on a bill, Mahathir dropped the other provisions. In addition, the sultans gave "verbal assurances"—without specific guarantees—that they would not withhold their assent to state legislation. [redacted]

#### **Mahathir's Position Weakened**

Mahathir's reputation as a promoter of Malay interests—and thus his position as party leader—clearly has been weakened. His struggle with the sultans has been successfully portrayed by his opponents as an unwarranted attack on Malay customs and tradition. The Bank Bumi scandal—in which an institution popularly identified with economic progress for ethnic Malays lost money in a dubious international business

deal with the ethnic Chinese—will cost him support among rural Malays and give ammunition to those who argue that the NEP benefits only the wealthy Malays. This is compounded by the government's austerity budget, which commits less funding to development projects supporting the NEP. [redacted]

In addition, the Bank Bumi scandal and the rapid growth of the foreign debt, according to the financial press, are tarnishing Malaysia's image among international bankers for competent economic management. And both bankers and foreign businessmen are beginning to take a second look at the assumption of an ever expanding Malaysian economy—a development that could threaten the foreign loans and investment crucial to the economic growth needed to sustain the NEP. Failure to meet the goals of the NEP would erode Mahathir's support within UMNO. [redacted]

Any further loss of public support or international confidence will encourage Mahathir's opponents within UMNO to challenge him at the party assembly in May. The Prime Minister has never totally controlled UMNO; even in his home state of Kedah, the Chief Minister attacked Mahathir for inaction over the Bank Bumi affair. But a direct attempt against Mahathir at the assembly would be unprecedented. Instead, we expect Razaleigh and the old guard to attempt to dislodge Musa Hitam—Mahathir's close ally and probable successor—from his position as deputy leader of UMNO (and thus from the deputy prime-ministership as well). But we do not rule out Razaleigh's directly challenging Mahathir for the party leadership if the latter's position is viewed as being weak enough to preclude a divisive struggle at the party meeting. [redacted]

#### **Heading Off the Opposition**

We expect Mahathir to weather the storm, but he probably will be forced to give way to the opposition in some areas. Among his more likely choices are:

- Compromise with the UMNO old guard, possibly offering Razaleigh the deputy spot and placing more old guard members in party and government positions in exchange for unified backing on the

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**Issues Affecting US-Malaysia Relations**

*US-Malaysian relations until recently were characterized by strident confrontation over international economic issues. The most acrimonious bilateral issue is commodities. Malaysia is the world's largest producer of both tin and natural rubber, which together brought in \$3.5 billion in 1980—a fourth of Malaysia's export earnings. Earnings from tin and rubber have fallen by more than a third since 1980 because of depressed international commodity markets. The importance of tin and rubber in the Malaysian economy transcends their role as export earners, however. Over 2 million people out of a population of 15 million depend on rubber as the primary source of income. Tin mining is largely controlled by wealthy Chinese who provide financial support for Mahathir's National Front.* [redacted]

*Mahathir claimed that US sales of tin from the GSA strategic stockpile beginning in 1981 depressed tin prices at a time when they were already low because of the global recession. Mahathir also claimed that the US refusal to participate in the Sixth International Tin Agreement—composed of both consumer and producer countries—weakens that organization's ability to prop up prices. Kuala Lumpur in 1982 attempted to fight what it viewed as US economic warfare by financing a large tin-buying operation on the London Metals Exchange and by promoting the formation of a tin producers' cartel—measures that were unsuccessful in raising the international price because of the global surplus of that metal. Last year Mahathir also promoted an unsuccessful attempt by the rubber producers' association to restrict the supply of natural rubber to drive up prices; international demand for rubber remained depressed because of the global recession. These efforts were accompanied by strident rhetoric attacking the commodity policies of Western countries.* [redacted]

*Moreover, Mahathir—who views himself as an economic spokesman for developing countries—has accused the West, and the United States in particular, of maintaining a global economic system that discriminates against developing countries by keeping*

*the international prices of commodities (tin and rubber) depressed and the prices of imported manufactured goods high. He has also publicly blamed the United States for following economic policies (high interest rates) that created the global recession.* [redacted]

*For nearly two years, the hostile atmosphere generated by these economic confrontations threatened to sour bilateral relations in other areas. The signing of a US-ASEAN memorandum of understanding on GSA tin sales last fall—in which the US agreed to limit sales to 3,000 tons a year through 1984—combined with an improving Malaysian economy have eased these strains. We expect, however, Mahathir to continue his push in the international arena for international commodity agreements and a new international financial system more attuned to LDC interests.* [redacted]

*Bilateral relations in other areas have been more amicable. In foreign policy, while Malaysia professes a nonaligned stance and does not want to appear to be a client state of the West, it is moving closer to the US position on many East-West issues. This, according to the Embassy, is because of an increased perception of the Soviet threat to Southeast Asia. Mahathir appreciates US support of ASEAN's efforts to resolve the Kampuchean conflict and, according to the Embassy, is increasingly reassured about the US security commitment to the region.* [redacted]

*Kuala Lumpur is also shifting toward closer defense cooperation with the United States. Joint military exercises, although not publicized in the Malaysian press, have increased from zero in 1981 to 13 in 1983. Malaysia looks increasingly to the United States for the training of military personnel, and the US Embassy expects expanded access for US P-3 surveillance planes to Butterworth Air Force Base.* [redacted]

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revised constitutional amendment and the bank scandal. This would neutralize Mahathir's short-term problems at the price of his image as a new man above the traditional, often corrupt Malay style of politics. It would reduce his acceptance among non-Malays.

- A push for greater Islamicization (Malay dominance) of Malaysian society to renew his Malay credentials. This could be done by requiring Malay as the language of instruction at all educational levels (elementary schools can at present use Tamil or Chinese as well as Malay), or by bringing all Malaysians under Koranic law. While such moves would mollify Malay conservatives and buttress Mahathir's reputation as a promoter of Malay interests, it might also upset the country's delicate racial balance.
- Adoption of an even more strident economic nationalist stance on international economic issues—perhaps a more determined advocacy of a “new Bretton Woods” agreement to restructure the world financial system in a way favorable to Third World countries—or on international commodities issues such as rubber and tin. This would reap domestic support but might frighten the international investment Malaysia wants to continue its economic progress. [redacted]

Mahathir can also call for a national election asking the voters to view it as a referendum on his handling of the bank scandal, the struggle with the sultans, and the austerity budget. While an election call fits into Mahathir's confrontational leadership style, we believe it would only be a policy of last resort. Mahathir and the UMNO-led National Front would most certainly win, but any net loss of seats would be viewed as an erosion of popular confidence in his leadership and would further stimulate an old guard challenge. [redacted]

#### Effects on US-Malaysia Relations

Mahathir's attempts to cope with his domestic problems could set back the recent improvement in relations with the United States. Mahathir has already expressed dissatisfaction with what he sees as a preponderance of Western influence over the world

economy, and has pushed a “Look East” program to pattern Malaysia's economic development along Japanese and Korean models. Nonetheless, he has usually been more accommodating in actual negotiations. If he feels himself losing popular support, however, the translation of his economic nationalist leanings into official policy implementation would be tantalizing. There is some danger that this might stimulate the Muslim fundamentalist, essentially anti-Western, strain among the ethnic Malay, making the resolution of difficult bilateral disputes virtually impossible. Moreover, a push to accelerate Malay control of the economy could put private US investment of about \$2.5 billion at risk. [redacted]

Bilateral relations could go either way if Mahathir were forced to resign. If he were replaced by Musa Hitam, we would expect the bilateral relationship to strengthen. According to the US Embassy, Musa, who studied at a US university, might be more understanding of US positions on bilateral economic issues. Mahathir's replacement by the more prickly Razaleigh and his old guard supporters, however, could lead to a more confrontational Malaysian approach on economic issues and a move away from the growing warmth in defense cooperation. [redacted]

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